

AER Ref: D14/195339

8 January 2015

Rob McMillan
Jemena Gas Networks (NSW) Ltd
General Manager Regulation
Locked Bag 7000
Mount Waverley VIC 3149

Dear Mr McMillan,

Thank you for your letter of 12 December 2014 and the teleconference discussion on 19 December 2014. Please find our response to each of the issues you have raised below.

1. Related party margin

We were relying on cl.15.1 of the FSA Annexure A which states that:

Except to the extent otherwise expressly provided for in the Contract, the Unit Rates, the rates and prices approved under Schedule W, all Work Order Sums and the Contract Sum are deemed to be the full cost inclusive of all consumables, construction facilities, constructional plant, temporary works, professional and technical services, royalties, Taxes (excluding GST), transport costs, equipment costs, labour and material costs, direct and indirect costs, overheads, margin and other services, charges and other costs necessary to perform the Contract Work.

Given this, our understanding was that the margin and service fee were captured within the proposed unit rate.

Notwithstanding this, our unit rates, calculated for the draft decision on connections expenditure, included the historical amount of related party margin applied (see the discussion at 2. below).

We would welcome further discussion to understand how the margin and service fee are reflected in the cost build-up of connections and the other routine capex works contracted under the FSA.

2. Connection unit rates

Our draft decision (p.6-24) outlined that we consider that one year of composition data (year to March 2013) applied to the contract unit rates is insufficient for estimating the future average unit rates. JGN has provided three years of composition data.¹ Due to the complexity of the JGN connections forecasting model we were unable to use this information in the time available to estimate unit rates incorporating this information. As discussed, we invite JGN to provide revised unit rates based on this information as part of its revised proposal.

In the absence of being able to rely upon unit rates derived from current contracts and with insufficient time to carry out benchmarking against other gas distribution businesses, we applied revealed unit costs.

These unit rates were derived from the unit rate information provided by JGN in RIN template table 4.3. The calculations were provided to JGN in the spreadsheet entitled 'AER - draft decision JGN -JGN Regulatory templates (CONFIDENTIAL) (UPDATE) - AER workings.xlsx'. Based on JGN's advice that direct overheads and related party margins were included in the unit rates in RIN template table 4.3², we made adjustments to our direct overheads allowance in order to avoid duplication of the direct overhead allowance for connections.

3. Government authority work

In making our decision we relied on the information included in JGN's proposal. As the pre-proposal/RIN conference material provided to the AER was not included in JGN's proposal we were not able to take it into consideration.

We continue to hold the position that historical expenditure and the associated contribution rate is the best method of forecasting this category of expenditure.

JGN's historical expenditure indicated an average expenditure of \$0.36 million per annum. This is what we relied upon. JGN did not include any information regarding the contribution rate. In the absence of information we applied our understanding of cost recovery practices employed by other gas distribution businesses. This is, that third party relocation of gas infrastructure is usually fully cost recovered.

As discussed, we would welcome the opportunity to revisit this decision on the provision of gross GAW expenditure and contributions data for the past five years.

4. Total planning costs

As part of JGN's total network overheads, JGN proposed network planning costs of \$8.5 million per annum on average and system planning costs of \$6.7 million per annum on average over the 2015-20 access arrangement period. Notwithstanding a downward trend in network planning costs over the last two access arrangement periods, we assessed network planning and system planning costs at a total level. As this total level expenditure was stable over time, we included the capex proportion of JGN's forecast planning and system costs in the AER draft capex decision on network and corporate overheads.

¹ JGN, Email 'RE: FOR FEEDBACK: Further substantiation/explanation of proposed connection unit rates', received 31 October 2014: Inlet tier data Apr10-Mar12.xlsx, Pipe movement Apr10-Sep11.xlsx.

² JGN, Response to connections question AER Information Request 40, Confidential, 22 October 2014, Note, p. 3.

As set out on p.6-46 of the AER's draft decision, JGN did not justify the additional \$5.6 million of planning expenditure it included in the facilities renewal and upgrade expenditure category. We would expect planning costs to be stable over time. We therefore did not approve any additional amount of planning expenditure.

Thank you for your time in exploring these matters with us in advance of submitting JGN's revised proposal.

Sincerely,



Mr. Sebastian Roberts
General Manager, Network Opex and Coordination

Kim Hugal
on behalf of